Distr.
GENERAL

GC.10/13
15 October 2003

United Nations Industrial Development Organization

ORIGINAL: ENGLISH

GENERAL CONFERENCE

Tenth session
Vienna, 1-5 December 2003
Item 9 of the provisional agenda

THE ROLE OF INDUSTRIAL DEVELOPMENT IN THE ACHIEVEMENT OF THE MILLENNIUM DEVELOPMENT GOALS

Industrial Development Forum

Theme paper submitted by the Secretariat

Abbreviations

AIDS	acquired immunodeficiency syndrome
FDI	foreign direct investment
GDP	gross domestic product
HIV	human immunodeficiency virus
LDC	least developed country
MDG	Millennium Development Goal
NEPAD	New Partnership for Africa's Development
PRSP	Poverty Reduction Strategy Paper
SME	small and medium enterprise
TB	tuberculosis
TICAD	Tokyo International Conference on African Development

Introduction

1. The key issue to be addressed at the Forum concerns the interface between the Millennium Development Goals (MDGs) and the initiation of sustainable industrial development processes in the least developed countries (LDCs). More specifically, the following questions will be posed:

(a) Why are the LDCs increasingly lagging behind the rest of the developing world and, save for a few cases, find it so hard to take advantage of successful policy experiences elsewhere?

(b) What is the role of the MDGs in enabling the LDCs to gear up for structural change and industrialization?

(c) How should structural change and industrialization be factored into the MDGs and the Poverty Reduction Strategy Papers (PRSPs)?

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V.03-88899 (E)
Distr.: 4 November 2003

The predicament of the LDCs

2. By all relevant measures the economic and social performance of the LDCs during the past three decades has been disappointing—with very few exceptions. Their declining shares in world trade and deterioration in productivity went hand in hand with an aggravation of the incidence of absolute poverty.

3. According to the Third United Nations Conference on the Least Developed Countries, over the last three and a half decades, the number of people living on less than US$1 a day went from 125.4 million to 278.8 million in 39 LDCs for which there are data. The situation has been particularly severe in the African LDCs, where the percentage of people in absolute poverty went from 55.8 per cent to 64.9 per cent, while it declined in 22 other developing countries. Similarly, the trends in human development indicators have been alarming. In over 30 LDCs for which data are available, more than one quarter of children are undernourished and the chances of a child dying before its fifth birthday are 1 in 10. On average, about 50 per cent of the female population is illiterate, and in 19 LDCs maternal mortality rate is close to 1 in every 100 live births.

4. The economic marginalization of the LDCs is eloquently shown by their weak growth performance and declining export shares. Although there are a few exceptions, average real GDP per capita growth was 0.9 per cent during the 1990s in all LDCs—excluding Bangladesh it was only 0.4 per cent. Other developing countries experienced on average 3.6 per cent per capita growth during the same period. It has also been estimated that LDCs' share in world commodity exports declined from 4.7 per cent in the early 1970s to 1 per cent in the late 1990s. In addition to the loss of market share and declining terms of trade during much of the 1990s, the LDCs experienced little or no productivity gains and, as a result, a growing gap with respect to the international technological frontier. Under these circumstances, LDCs also failed to attract much needed capital investment, accounting for only 0.5 per cent of global flows in FDI, at a time when the net Official Development Assistance was also declining in real per capita terms.

The response

5. The MDGs are a set of quantified and time-bound goals ranging from halving extreme poverty to attaining universal primary education to halting the spread of HIV/AIDS to promoting gender equality to ensuring environmental sustainability by 2015.

6. The MDGs are a collective response of the international community focused in particular on the abject poverty and humanitarian crisis of the LDCs—most of which are located in sub-Saharan Africa. Stemming from the September 2000 Millennium Declaration signed by the leaders of 189 Member States of the United Nations and reaffirmed in 2002 at the Monterrey International Conference on Financing for Development and the Johannesburg World Summit on Sustainable Development, the MDGs address dimensions that are global in scope and significance and country-specific in application.

7. The whole of the multilateral system, including the United Nations Secretariat and the multilateral agencies, is involved in this unique enterprise. This response is not just a humanitarian act. It is also a way to help trigger endogenous growth processes that will enable the LDCs to stand on their own feet and take command of their own development processes.

8. What will it take for them to do so?

First, addressing structural hurdles. The MDGs are aimed at removing the most egregious barriers to the induction of sustainable development processes.

Second, gearing up for structural change, adapted to LDCs' specific conditions.

Third, effectively mobilizing LDC societies to take advantage of scientific and technological knowledge to foster growth by strengthening the competitive capacity of the private sector and enhancing productivity so as to be able to sustain human development and social change over time.

9. In a significant way, the quest for the achievement of the MDGs requires us to turn back to the development fundamentals.

Back to the fundamentals

10. Accounting for LDCs' appalling performance over the last few decades calls for more than the conventional approaches to catching up. In particular, it entails the need to look at the case of LDCs in broad perspective, taking some distance from the usual debates on development applied to other regions. LDCs will continue to draw little or no benefit from lessons learnt about the experience of other developing countries and regions as long as its fundamental development specificities continue to be neglected.

11. In assessing the long-term economic performance of the LDC economies, measures such as (very low) physical and human capital accumulation and price distortions—with most of the reason attributed to ineffective policies and bad governance—are among the most usually resorted to. This level of explanation has captured much of the attention in the literature, including numerous papers on growth accounting,

fiscal, monetary and exchange rate management, macroeconomic incentive systems and transaction costs.

12. These explanations relate to the *proximate* determinants of growth of per capita income, namely, physical capital deepening, human capital accumulation and productivity growth. They lead to concerns relating to the determinants of investment decisions such as the investment climate and macroeconomic stability. An important feature of this approach is that it factors in both the resource endowments of the economy and the efficiency with which such endowments are deployed, thus leading to policy inferences that concern either static or dynamic comparative advantages or both—the latter normally receiving far less attention than the former.

13. Complementarily, productivity growth may also be addressed not as an accounting residual, but in terms of (at least some of) its *direct* determinants such as those relating to the microeconomic, technological and entrepreneurial behaviour. Although this approach may relate to alternative theoretical paradigms (e.g. that of evolutionary economics, as opposed to conventional theory), it can broadly be fitted within the above framework in the sense that it also accounts for *proximate* growth determinants. In particular, it focuses on the development of *man-made* comparative advantages. This strand of explanations provides a very different perspective, rich in additional insights about the role of endogenous variables. Important amongst such insights are those relating to the (in)capacity of national enterprises to compete in the domestic and international markets. These lead to policy concerns on the promotion of entrepreneurship, learning and technological diffusion.

14. One of the problems with the exclusive focus on *proximate* and *direct* determinants is that the conditions for policy replicability cannot be properly addressed because too much is taken for granted, for instance, by not specifying many initial conditions. This is especially critical since, while some of these conditions are exogenous, others change slowly over time and will impact the policy outcomes of the future.

15. Another problem is that such focus often makes *causal* implications to become blurred. This is because not only it is very hard to gauge the *relative* influence of different determinants, such as factor accumulation vis-à-vis technological change (in fact, such influences are not really independent), but also due to the influence of *other* (largely non-economic) determinants that are not captured by these approaches. This raises the possibility that causality may run, to some extent, from growth to accumulation and productivity, rather than the other way around.

16. The search for more *fundamental* explanations addresses questions such as: if differences across countries in per capita income growth in the long run are largely due to their ability to enlist innovation and technical change for productivity growth, what is it that determines differences in such an ability? And, more broadly, what is it that determines cross-country differences in developing countries' ability to succeed in technological catch-up?

17. Those relating to institutions, geography and patterns of integration into the world market are among the various explanations offered at this deeper level. These explanations have generated a lively debate in the literature but not enough effort has been devoted to take due stock of this debate from the LDCs' perspective so far.

18. An additional reason why it is important to look at the fundamentals is that they are not just about conceptual issues but they also concern the nature of the quantitative evidence required to explain success and failure in catching up. This is particularly relevant with respect to initial conditions. No analysis of LDC development problems that neglects initial conditions and structural barriers can be expected to provide either a relevant assessment of their development problems or realistic policy guidelines.

Removing structural impediments to attain MDG-compatible growth

19. Because the LDCs are unable to pull themselves out of their predicament, for which the international system is partly accountable, reaching the minimum thresholds to get out of the poverty trap entails a shared responsibility with the donor countries.

20. Such thresholds relate to standards of governance, basic health care and education, agricultural productivity and core infrastructure, among others. Failing to meet these thresholds amounts to falling into a low-level equilibrium that is unable, in and of itself, to generate the necessary dynamics to break the poverty trap, thus preventing the transition to sustained growth. This may also happen in countries that have managed to achieve reasonable rates of growth, albeit at a subnational level, giving rise to substantial localized pockets of poverty.

From MDG-compatible growth to structural change

21. Reaching minimum thresholds and, indeed, the MDGs themselves, ought not be seen as points of arrival, but as points of departure towards sustainable development—economically, socially and environmentally.

22. If, while working towards building up the conditions for LDCs to reach the MDGs, due attention is not also paid to preventing the likely potential relapses that may stem, for instance, from extremely high vulnerability to external shocks because of very high commodity dependence, an important opportunity might be lost. Certainly, both steps should go hand in hand. But can this be taken for granted? The risks involved in failing to take advantage of the major effort required to reach the minimum thresholds so that subsequent development is possible need to be explicitly addressed. Consider the role of the private sector and science and technology development.

23. Ensuring the success of efforts towards creating the basic preconditions for development rests on a wide range of ingredients needed for wealth creation. This entails, among others, establishing at least the rudiments of a technological infrastructure responsive to the needs of private enterprises, that is, the domestic provision of public goods that are required to foster technology diffusion processes that can eventually lead to catching up in productivity.

24. Institutions for the facilitation of domestic technology diffusion have played a key role in all developing countries that have succeeded in the path of industrialization. Among them, those relating to the quality system (including capacity in metrology, testing, standardization, traceability and quality management) are becoming indispensable even in countries at a very early stage of manufacturing development simply because of the stringent health, safety, environmental and other technical regulations and conformity requirements imposed by advanced industrial countries.

25. Technical education and privately run or mixed apprentice systems complement on-the-job training to support the development of skills required to promote learning processes in industry.

26. SME and gender-sensitive entrepreneurship promotion includes financial support in the form of loans with subsidized interest rates, credit and insurance-guarantees or grants aimed at stimulating particular activities, such as exports, technological learning, innovation and investment and are designed to make up for SMEs' regional or sector-specific disadvantages. SMEs can also be supported through "soft aid" such as consulting services, information, training and assistance aimed at facilitating the establishment of export consortia and local clusters. A further form of assistance is that aimed at developing suppliers' and subcontracting networks with large enterprises, including SMEs.

27. Design, project and process engineering skills and capabilities are key means of technology transfer and absorption and, as such, call for priority treatment through special fiscal and financial incentives.

28. If, among others, these ingredients that are required to embark upon a path of diversification, structural change and productivity growth are ignored, the MDGs may fail to start off sustained development processes even if they largely succeed in relieving the most eloquent indices of backwardness.

29. No country has been able to grow steadily for a substantial period of time and at the same time reduce poverty significantly, without undergoing a sustained process of structural change. In most cases, such a process entails major gains in allocative efficiency through shifts in employment from low productivity to high productivity and from primary to industrial activities.

30. The key to structural change is *not* the growth of this or that sector, but increases in economy-wide productivity. Exactly how such increases are attained depends a lot on the specific constellation of countries' natural and man-made advantages and historical trajectories, the role of foreign investment and the priority given to human development, among others.

31. As Nigerian President Olesegun Obasanjo recalled at the recent TICAD III meeting in Tokyo, NEPAD, with the assistance of UNIDO, is working on providing a comprehensive vision for building Africa's productive capacity. This is the kind of medium- to long-term supplement called for by the MDGs, which should not be understood as the ultimate solution to all LDCs' problems. But they are a necessary step to start off the endogenous process needed to tackle these problems decisively and effectively. The political energy involved in pursuing the MDGs will only bear the expected fruits if translated into nationally-owned, nationally-driven and effectively conducted development strategies that fully address the dramatic accelerations in the pace of progress called for.

32. Provisional UNIDO estimates for the forthcoming *Industrial Development Report* indicate that the modal MDG-required rate of growth is 5-6 per cent per annum during 2003-2015, with wide variations across countries. As a number of PRSPs explicitly suggest, sustaining this kind of economic growth calls for important transformations in the structure of the economies involved, including export diversification and a shift in the composition of manpower towards industrial activities, as a necessary supplement to the substantial increases in agricultural productivity that will be required. This will be necessary to prevent further increases in the growing contingents of marginalized internal migrants from the manpower to be released through the modernization of agriculture.

33. The sectoral and subsectoral dimensions are important in this respect. The poverty elasticity of growth varies across sectors, so the first reaction may be to focus on those sectors that have relatively higher poverty elasticity. However, although this may make sense in the short run, it may fail to do so in the medium and long term simply because sector elasticities have to be weighted by the respective sector-specific growth potential as well as by their indirect impact on economic activity and job creation.

34. But this in turn raises questions that need to be addressed. For instance, how to avoid that the substantial internal migrations that can be expected as a result of rapid increases in agricultural productivity end up adding to the massive pockets of jobless people in urban and suburban areas? How can the LDCs develop a comparative advantage in manufactures? What would it take for a focus on labour intensive-based industrialization to avoid falling into the fallacy of composition whereby what may be a solution for a few countries may end up being a dead-end if pursued by many countries at the same time? How far may LDCs share in the gains stemming from liberalization of trade in textiles and clothing? Does plugging into international production networks provide an alternative to the extent of export diversification otherwise entailed? Or, can natural resource industrialization offer a way out to the employment needs associated to the kind of structural change required?

35. The Global Compact addresses a number of these issues. In particular, it submits six policy clusters for escaping poverty traps which, in addition to those relating to human development, small farmers, investment in infrastructure, human rights and social equity, also include two of most direct relevance to the present discussion: namely, those relating to the environment and to industrial development policy. Let us quote the latter:

> "*Developing industrial development policies that bolster non-traditional private sector activities, with special attention to small and medium-sized enterprises. Such policies might include export processing zones, tax incentives and other initiatives to promote investment and public spending on research and development.*"

Millennium Development Compact, Millennium Project

36. These insights of the Global Compact, complemented by considerations such as those discussed further above, should help to fill gaps in the spelling out of the strategies required to achieve and sustain the MDGs.

37. Are the MDGs attainable? The answer is: they are, provided that the amount and quality of resources and interventions match the magnitude of the goals and, as importantly, that domestic conditions are laid down in such a way as to make progress in the standards of living and in the direction towards the goals sustainable over time.

38. Overall, while the recent work done by the World Bank and independently by the Zedillo Commission in preparation for the Monterrey Conference show figures of over an *additional* $50 billion a year needed to achieve the MDGs, more specific forecasts need to be made in light of the interdependencies between the MDGs and the structural change implications of sustaining their impact. A further exercise should also be undertaken to formulate a financial strategy to achieve these targets especially on a country basis as is increasingly being done in some of the PRSPs but with a much shorter time horizon.

UNIDO, industrialization and the MDGs

39. The key role for industrial development, given the extent of structural change called for by the poverty MDG, is to generate sustainable employment and higher incomes to lift people out of poverty. This also entails industry's direct and indirect contribution to the achievement of other MDGs, and non-economic measures of well-being in general.

40. While most studies emphasize the multi-dimensionality of poverty and highlight the importance of health, education and gender equality, few indicators address the two-way causality between poverty reduction and the other MDGs. It is widely accepted that, as better education and health for the poor will improve their chances of escaping poverty, at the same time higher incomes for the poor will typically enable them to have greater access to these services and make more investment in human capital for the next generations.

41. For example, higher gender inequality is found to increase poverty and reduce other welfare measures, as women appear to allocate more resources to food, healthcare and education of their children than do men, and female literacy has been found to be one of the most important determinants of the effects of growth on income poverty. Moreover, inequality in access to education, technology and employment opportunities for women reduces economic growth as it fails to make adequate use of female resources. Enhancing employment of women in key agro-industries and low-skilled manufacturing such as in textiles and apparel as well as through micro and home-based enterprises and community cooperatives helps to empower women, which in turn is found to decrease childhood malnutrition and under-5 mortality.

42. Similarly, the dire impacts of HIV, TB and malaria on labour productivity and human capital

accumulation are imposing important challenges particularly in Africa both in terms of future growth and poverty alleviation. The policy response to minimize the impacts of these challenges has been weak, except for a few successful examples, at least partially due to the lack of resources and infrastructure. In this regard, enhancing local pharmaceutical production capabilities and improving access to treatment and medical facilities can be important contributions from technical cooperation activities.

43. Finally, poverty and the state of the environment are deeply interrelated. In most LDCs where the poor are exclusively relying on the exploitation of natural resources, the sustainability of their livelihood is intrinsically dependent on the quality of their environment. Over-reliance on natural endowments and the single-tier economy exposes the already marginalized groups to volatility without adequate measures to insure against risks. Rather than being the culprit of environmental destruction, industry can provide solutions if the necessary steps are taken to insure that industrial development in LDCs, while effective in reducing poverty, is also ecologically efficient. Along these lines UNIDO works to improve the environmental performance of domestic industries by promoting the diffusion of clean technologies, better energy supply and efficiency, especially in rural areas—as well as through the implementation of the Montreal and Kyoto Protocols.

Summary of key issues to be addressed by the Forum

44. The MDGs have become the international community's universal yardstick of success in the fight against poverty. But sustained poverty reduction entails a parallel quest to develop the endogenous structural change processes that are necessary for sustainable job creation and improvements in the standards of living. Therefore, there is a two-way interaction between the MDGs and industrialization: while the former are necessary to remove structural barriers to growth, the latter is required to sustain growth in the long term.

45. The exchanges during the Industrial Development Forum will attempt to provide answers to the following key questions:

(a) Which are the fundamental reasons why the LDCs increasingly lag behind and, save for a few cases, find very hard to take advantage of successful policy experiences elsewhere?

(b) What is the role of the MDGs in helping the LDCs to gear up for structural change and industrialization?

(c) How best to factor structural change and industrialization into the MDG and Poverty Reduction Strategy Papers processes so as to sustain human development and social change over time by strengthening the competitive capacity of the private sector and enhancing economy-wide productivity growth?

46. In addressing these issues, priority attention will be paid to the key role to be played by the multilateral technical cooperation system in creating domestic capacity and fostering the international diffusion of know-how. These are indispensable preconditions to enable the LDCs to enhance productivity for social advance by developing man-made comparative advantages, diversifying exports and ensuring a more active participation in world trade and investment.